LEGISLATIVE STUDY COMMISSION ON A SYSTEM OF MERIT PAY FOR STATE EMPLOYEES

REPORT TO THE
1989 GENERAL ASSEMBLY
OF NORTH CAROLINA

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January 9, 1989

TO THE MEMBERS OF THE 1989 GENERAL ASSEMBLY:

The Study Commission on Merit Pay for State Employees herewith submits to you for your consideration its final report. The report was prepared by the Study Commission pursuant to Section 27 of Chapter 1086 of the 1988 Session Laws.

Respectfully submitted.

Senator Thomas F. Taft

Representative Margaret Stamey

Cochairmen
Study Commission on Merit Pay for State Employees

PREFACE

The study of Merit Pay for State Employees was authorized by Section 27 of Chapter 1086 of the 1987 Session Laws 1988 Session. The Commission was chaired by Senator Thomas F. Taft and Representative Margaret Stamey. The membership of the Commission is listed in Appendix B of this report. A committee notebook containing the committee minutes and all information presented to the committee is filed in the Legislative Library.

The Legislative Study Commission on a System of Merit Pay for State Employees met four times after the 1988 legislative session. In the course of these meetings, the Committee members were briefed on the State compensation system, merit pay systems of other government entities, and employee morale problems that have resulted from the freeze on merit pay in effect since 1982.

The first meeting was held on September 29, 1988. The focus of the meeting was on providing the Commission members with background information on the State's compensation system and with a history of merit pay in the State. Mr. Robert Morgan, Director of the State Bureau of Investigation, spoke to the members on problems he faces as an agency head as a result of the freeze on merit pay. Most significant is the loss of agents to other employers which represents not only a loss of personnel but also a loss of the dollars spent to recruit, hire, and train new agents to replace them. Additionally, the SBI faces a severe morale problem due to agents' not being able to progress through their pay grades as those in other law enforcement agencies exempt from the State Personnel Act are able to do. Mr. Morgan pointed out that only one of his agents is in the top step of his pay grade while all but one State Highway Patrol agents are in the top step of their grades.

Mr. G. C. Davis, Mr. Don Huffman, and Ms. Margaret Graham, of the State Office of Personnel, then made presentations outlining the State's compensation plan. Mr. Davis presented a history of salary programs in North Carolina from before 1949 when there was no pay plan, through 1982 when funding for merit pay was frozen to the present. Mr. Huffman discussed the objectives the State should achieve with its

compensation program. Overall, compensation should be sufficient to allow the State to attract, retain, and motivate the high calibre of employee needed to carry out the State's business. This requires a compensation program that provides for both internal equity and external competitiveness. Finally, Ms. Graham spoke on performance incentives and what results when these incentives are lacking. Among the results are a majority of employees leaving State employment after less than three years, a majority of State employees being bunched below the midpoint of their salary grades, and new employees making the same salaries as more experienced employees.

Ms. Janet Blalock, of the Office of the State Auditor, spoke to the Committee on previous studies of the merit pay issue, all of which reached the same basic conclusions. These are that the State's pay system rewards on the basis of status as an employee rather than on performance which results in salary inequities, low morale, and limits on managers' abilities to get maximum productivity from their subordinates.

The Committee held its second meeting on November 28, 1988. Mr. Ed Kitchen, Assistant City Manager of Greensboro, spoke to the Committee on that city's merit pay program. First, Mr. Kitchen described the program which was instituted in 1975 and which awards salary increases entirely on the basis of job performance. Then he discussed with the members some of the problems the city faced in implementing the program and how they were addressed. He credited the decision of the City Council not to get involved in individual employee merit pay decisions for much of the successful implementation of the system.

Mr. Durward Gunnells of the State Employees Association addressed the members on behalf of the Association. He stated that the number one goal of the Association is to achieve a pay plan that, among other goals, includes salary increases combining both general and merit increases. Mr. Gunnells' discussion of problems with the pay system

reinforced the views presented by speakers at the previous meeting. Mr. Gunnells then called on Ms. Kay Wijnberg, Association President, to report her observations of employee sentiment regarding the pay system and the merit pay issue.

Mr. Sam Connally, Associate Personnel Director at UNC/Wilmington, then spoke to the Committee about pay system inequities that have been brought to his attention by UNC employees. He strongly urged the Committee to make a favorable report to the General Assembly on the reinstatement of merit pay. Following Mr. Connally's presentation, Committee Counsel presented information requested by the Committee on merit pay systems in other states and a compilation of the issues presented by the speakers at the September 29th meeting. After Committee discussion of the issues, the meeting was adjourned.

The Committee met again on December 12, 1988. Ms. Margaret Graham of the Office of State Personnel gave a presentation on the 1988-89 compensation report recently completed by the Position Management Division, which was discussed at length by the Committee. Committee Counsel then reviewed the issues presented at previous meetings. The floor was then opened for Committee discussion. Following discussion on a motion that the Committee go on record as favoring a combination merit/general salary increase, Representative Betty Wiser presented a bill for consideration. The Committee discussed the bill, making several suggestions for additions to it. It was decided that no action would be taken on either the motion or the bill. Counsel was directed to prepare a second draft incorporating the Committee's suggestions.

The final meeting of the Committee was held on January 9, 1989. Counsel presented a redraft of the bill discussed at the December 12, 1988 meeting. Two amendments were presented and approved for incorporation in the bill. The bill, as amended, was then approved for recommendation to the General Assembly.

Mr. G. C. Davis, Office of State Personnel, requested that the Committee vote to recommend an appropriation of funds to implement the provisions of the merit pay bill involving that Office. After Committee discussion, the members voted to incorporate the recommendation in the report and directed Counsel to prepare such a bill.

As its final business, the Committee approved the draft of the study report subject to the inclusion of a record of the day's proceedings and the amended bills.

FINDINGS AND RECOMMENDATIONS

The Study Commission on a System of Merit Pay for State Employees heard much testimony on the detrimental effects of the freeze on merit pay increases since 1982. In addition, testimony regarding problems with the existing merit pay system was presented. As a result of this testimony, the Committee found that the lack of merit pay increases has caused serious morale problems among State employees and has affected the ability of the State to retain good employees.

To alleviate this situation, the Committee recommends that the merit pay system, as found in G.S. 126-7, be revised and that merit pay increases for eligible State employees be part of the annual salary increase appropriation. These recommendations are incorporated in the bill attached to this report as Legislative Proposal I in Appendix C.

Because the proposed revised merit pay program requires extensive monitoring by the Office of State Personnel, the Committee also recommends that funds for implementation of the monitoring provisions be appropriated. This recommendation is incorporated in the bill attached to this report as Legislative Proposal II in Appendix C.

APPENDIX A

CHAPTER 1086
HOUSE BILL 2641

AN ACT TO APPROPRIATE FUNDS FOR THE 1988-89 FISCAL YEAR.

The General Assembly of North Carolina enacts:

. . .

Sec. 27. (a) The Legislative Study Commission on a System of Merit Pay for State Employees is created.

. . .

(d) The Study Commission shall conduct a study of a system of merit pay for State employees.

. . .

Sec. 173. Except as otherwise provided, this act shall become effective July 1, 1988.

APPENDIX B

MEMBERSHIP OF LEGISLATIVE STUDY COMMISSION ON A SYSTEM OF MERIT PAY FOR STATE EMPLOYEES

Lt. Governor's Appointments

Sen. Thomas F. Taft, Cochair
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APPENDIX C

LEGISLATIVE PROPOSAL I

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

D

89-RZ-006
THIS IS A DRAFT 10-JAN-89 14:11:21

Short Title: Merit Pay Policy (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REVISE THE MERIT PAY SYSTEM IN EFFECT FOR STATE EMPLOYEES SUBJECT TO THE PROVISIONS OF CHAPTER 126 OF THE GENERAL STATUTES

The General Assembly of North Carolina enacts:

Section 1. G.S. 126-7 reads as rewritten:

"**§ 126-7. Compensation of State employees.**--(a) It is the policy of the State to compensate its employees at a level sufficient to encourage excellence of performance and to maintain the labor market competitiveness necessary to recruit and retain a competent work force. To this end, salary increases to State employees shall be based, in part, on each individual employee's job performance and, in part, on general increases given to all State employees.

(b) To guide the Governor and the General Assembly in making appropriations to further the compensation policy of the State, the State Personnel Commission shall conduct annual compensation surveys. The Commission shall determine the percent of funds appropriated for salary

increases to be reserved for a general increase for all State employees and the percent to be reserved for performance-based merit increases for eligible employees. The Commission shall present its recommendation on the percentages and the results of the compensation survey to the Appropriations Committees of the House and Senate no later than two weeks before the convening of the legislature in odd years and May 1st of even years. The amount reserved for merit increases shall not be less than twenty-five percent (25%) nor more than seventy-five percent (75%) of the total salary increase appropriation.

(c) Merit increases shall be based on performance appraisals of all employees conducted by each employing unit. The State Personnel Commission, under the authority of G.S. 126-4(8), shall adopt policy and regulations for performance appraisal. The policy and regulations shall include the following:

(1) Each employing unit's appraisal system shall be designed and administered to ensure that merit increases reward only performance that is satisfactory and above and are distributed fairly.

(2) To be eligible to distribute its share of the merit increase allocation, an employing unit shall have an operative performance appraisal system which has been approved by the State Personnel Director.

(3) The State Personnel Director shall help employing units to establish and administer their performance appraisal systems and shall provide initial and ongoing training in performance appraisal and performance system administration.

(4) An employee whose performance rating is satisfactory and above is eligible to receive a merit increase. An employee whose performance rating is below satisfactory shall not receive a merit increase.

(5) The State Personnel Director shall set the maximum merit increases allowable for levels of performance that are satisfactory and above. Individual merit increases may vary depending on an employee's job performance and position within salary grade. A supervisor's performance appraisal

plan, evaluation standards for each employee, and individual employee ratings and merit increase amounts shall be reviewed by the immediate supervisor who can approve increases up to the maximums set by the State Personnel Director. A merit increase to an employee above the maximum set for his level of performance must be approved in writing by the State Personnel Director.

(6) An employee who believes that his performance was not evaluated fairly, that he was unfairly denied a merit increase, or that he received an insufficient increase based on his performance appraisal must first discuss the problem with his supervisor. Appeals of the supervisor's decision shall be made only to the employing unit's grievance committee or internal merit review board. The State Personnel Director shall help an employing unit to establish an internal merit review board or, if it includes employee members, to use its existing grievance committee to hear merit pay disputes.

(7) The State Personnel Director shall monitor the performance appraisal system and merit increase distribution of each employing unit. Each unit shall submit data required by the Director on the administration of the performance appraisal system within that unit annually. The Director shall analyze the data to ensure that merit increases are distributed fairly within individual employing units and across all such units of State government and shall report back to each unit on its appraisal and distribution performance.

(8) The State Personnel Director shall report annually on the merit pay program to the Commission. The report shall evaluate the performance of each employing unit in the administration of its appraisal system and the distribution of merit increases within each unit and across State government. The report shall include recommendations for improving the performance appraisal system and alleviating inequities. Copies of the report shall be sent to the State Auditor.

(9) The Commission shall report annually to the Governor, the Lieutenant Governor, the President Pro Tempore of the Senate, the Speaker of the House of Representatives, and the Standing Personnel Committees of the House and the Senate. The Commission report shall include an evaluation of each employing unit's administration of its appraisal system and distribution of merit increases. The State Personnel Director shall recommend for approval by the General Assembly sanctions for employing units that have deficient appraisal systems or that do not link merit increases to performance.

(d) The provisions of subsections (a), (b), and (c) shall not affect the system of longevity payments established by the State Personnel Commission."

Sec. 2. This Act shall become effective January 1, 1990.

LEGISLATIVE PROPOSAL I

SECTION-BY-SECTION ANALYSIS

Section 1 of the bill amends G.S. 126-7 which sets out the State's present merit pay provisions. Subsection (a) states that it is the policy of the State to recruit and retain a competent work force by compensating employees competitively with the existing labor market. This result will be achieved by basing salary increases on a combination of individual employee job performance and on general, across-the-board increases.

Subsection (b) requires the State Personnel Commission to make annual compensation surveys in order to provide the Governor and the General Assembly with the information necessary to make appropriations for salary increases that will enable the State to meet the above-stated policy goals. The Commission will decide the percent of any funds appropriated for salary increases to be used to provide a merit increase for eligible employees and the percent to be used for a general increase for all employees. This recommendation along with the results of the yearly compensation survey must be presented to the Appropriations Committees of the House and Senate by two weeks before the convening of the odd-year session and by May 1st of the even-year session. The amount reserved for merit increases must be no less than 25% of the total appropriation but cannot exceed 75%.

Subsection (c) mandates that merit increases are given on the basis of performance appraisals and directs the Commission to establish policy and regulations for performance appraisal. This section then sets out certain specifics which must be contained in the policy and regulations. Each

employing unit must have a functional performance appraisal system which has been approved by the State Personnel Director before it can distribute merit funds. The State Personnel Director will help units get their systems up and provide ongoing help in their administration. Merit increases are given only to those employees whose performance is satisfactory and above. The State Personnel Director will set maximum increases for levels of performance that is satisfactory and above. Employing unit supervisors can approve increases up to these maximums. If a supervisor wishes to give an increase greater than an established maximum, it must be approved in writing by the State Personnel Director. Supervisors must have their appraisals and recommended increases approved by their immediate supervisors.

Subdivision (6) establishes a procedure for reviewing employees problems with merit pay decisions. As with the procedure for employee grievances in G.S. 126-34, an employee must first discuss any problem with his increase amount or his performance evaluation with his immediate supervisor. If the employee is still dissatisfied, he may then appeal to the unit's grievance committee if this committee's members include fellow employees. If the committee does not have employee members, the Director of State Personnel will help the employing unit to set up an internal merit review board with employee members to hear merit pay disputes. The Director will also help employing units adapt their existing grievance committees to this use. Decisions of the grievance committee or internal merit review board are not appealable to the Office of Administrative Hearings.

Subsection (c) also mandates a monitoring system to ensure that merit funds are fairly distributed. This system will include requirements for annual reports to be submitted by employing units to the Director, analysis of the data

submitted, and an evaluation of and report back to each unit on its performance. The system will also include reports to the State Personnel Commission and to the Executive and Legislative branches. With General Assembly approval, employing units that are not adequately or fairly administering their performance appraisal systems may be sanctioned.

Subsection (d) maintains the separation between merit and longevity pay.

Section 2 makes the Act effective on January 1, 1990.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1989

D

89-RZ-007
THIS IS A DRAFT 10-JAN-89 14:11:27

Short Title: Funds to implement merit pay. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO APPROPRIATE FUNDS TO THE DEPARTMENT OF ADMINISTRATION TO IMPLEMENT THE MERIT PAY PROGRAM.

The General Assembly of North Carolina enacts:

Section 1. There is appropriated from the General Fund to the Department of Administration the sum of ninety-eight thousand nine hundred six dollars ($98,906) for the 1989-90 fiscal year and ninety-one thousand ninety-five dollars (91,095) for the 1990-91 fiscal year to implement the merit pay program.

Sec. 2. This act shall become effective July 1, 1989.

LEGISLATIVE PROPOSAL II

SECTION-BY-SECTION ANALYSIS

Section one of this bill appropriates funds to the Department of Administration, Office of State Personnel, to be used to implement the merit pay program. The purpose of the funds is to provide the Office with the manpower needed to adequately monitor the administration of the merit system by individual employing units.

Section 2 makes the Act effective on July 1, 1989. This is done to allow the Office sufficient time to gear up for the implementation of the merit pay program in January 1990.